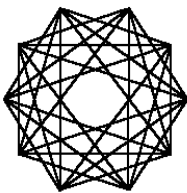


USAID/PADCO

**Pension
Reform
Program
in Ukraine**



NOVEMBER 1999



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PENSION REFORM IN UKRAINE

**PREPARED FOR USAID WORKSHOP
ON PENSION REFORM IN THE ENE**

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1. AN OVERVIEW OF PENSION REFORM IN UKRAINE

1.1. INTRODUCTION

Social sector reform in Ukraine has been a successful collaboration between the Government and international donors – led and coordinated by the United States Agency for International Development. USAID assistance has emphasized on supporting systems that are fiscally sustainable. Although the program of pension reform did not start until late 1997, significant progress has already been made. The table below lists the major USAID-sponsored activities related to pension reform conducted by PADCO during the period 1997 – 1999 as well as the tangible outcomes achieved during each year.

One way to measure how well the social sector reform program has met the needs of the Government of Ukraine is the extent to which the fiscally strapped GOU has spent its own money to implement reforms supported by USAID, including:

- The Pension Fund has recently purchased 3,000 computers and related equipment to support the automation of local office operations.
- The Ministry of Labor and Social Policy has created an e-mail system using government lines to all oblasts and is now extending this system to all local offices in 609 raions and 145 oblast subordinated cities and towns.
- The Ministry of Finance approved and financed the creation of an Office of the Actuary within the Pension Fund with 5 staff;
- The GOU has enacted over 50 Presidential and Cabinet decrees needed to implement recommendations of the USAID/PADCO social sector reform project;
- The GOU implemented large scale pilot projects to develop new personified reporting systems for the Pension Fund and to link pension offices with targeted social assistance offices;
- The State Committee for Statistics has committed its staff to the regular implementation of a newly-designed Quarterly Survey of Income and Expenditure that will serve as the basis for reforming the system for establishing the poverty level and minimum pensions.
- The Pension Fund will spend \$30 million over 3 years to personify records for the state pension system, has set up a separate personification office in Kyiv, and assigned a personification coordinator in each raion.

1.2. WHY PENSION REFORM NEEDS USAID TECHNICAL SUPPORT

Recognizing the need to reform Ukraine's social protection systems, USAID began in 1994 providing technical assistance to the Government of Ukraine. The initial goal was to support reform of the chronically weak state pension system. In January 1995, USAID extended its assistance to help create a targeted assistance program to protect households from the impacts of rising prices for housing and utilities.

Implementing social sector reform, however, faced daunting obstacles. Few Ukrainians understood how social protection systems operate in market economies. Neither the public nor government officials understood the extent or the nature of the problems ailing their programs, nor how to improve the worsening situation.

Unfortunately, the basic building blocks for a new social protection system were missing. Reliable data on economic and social conditions were almost wholly missing. The administrative infrastructure to manage social protection programs was also absent. "Pension cases," for example, were handled at the local level, with only summary information -- or misinformation -- shared with higher levels of government. There were no national databases of pensioners, invalids or working contributors to the pension system. Computers, copiers, calculators, and communications systems (and people who knew how to use them) were absent. Most offices lacked even stationary, bookshelves, and pens. Management systems had never been developed and neither financial flows nor program effectiveness were audited. Office procedures were learned by rote; offices lacked training programs, manuals, and even copies of enabling legislation.

Technical assistance would not have succeeded had it been limited to expert advice. However willingly GOU counterparts listened to foreign experts about how to design reforms, they lacked the institutional infrastructure and staffing skills to implement even modest changes. Lacking even rudimentary office equipment, and unable to pay for long distance telephone calls, officials could do little without assistance, no matter how strongly they supported proposals for reform. Success of pension reform initiatives has depended on providing practical and comprehensive assistance that has helped the GOU with all phases of reform.

ACTIVITIES AND ACHIEVEMENTS OF USAID/PADCO PENSION REFORM PROJECT	
1997	
<i>USAID/PADCO Project Activities</i>	<i>Tangible Outcomes</i>
<ul style="list-style-type: none"> Designed and tested first prototype of the individualized pension reporting system Created Electronic Library of all normative acts, automatically updated, installed in all oblasts and large local social protection offices and pension departments Created e-mail system linking oblasts and many local offices to the Ministry of Labor and Social Policy Developed automated system for linking housing subsidy offices, local pension offices, and State Tax Administration 	<p>Feb-June: Legal and policy support provided to Pension Reform Task Force of the Cabinet of Ministers</p> <p>June: Ministry begins to use e-mail to issue instructions, rules and regulations to oblasts and local offices</p> <p>September: Two-week seminar held on social statistics and reporting systems for GosKomStat and oblast officials</p> <p>December: Completion of pilot program to create personified pension reporting system</p>
1998	
<i>USAID/PADCO Project Activities</i>	<i>Tangible Outcomes</i>
<ul style="list-style-type: none"> Designed software and training program for oblast and local office management information systems Developed actuarial model for state pension system, using World Bank PROST model, and Excel model Plan for creation of Office of the Actuary and design of qualifying mathematics exam Analysis of poverty assessment methodologies with recommendations for reform Begin assistance to Pension Fund to create nationwide personified reporting system Seminars held on private pension reform issues 	<p>July: Actuarial analysis of current and proposed pension system completed</p> <p>September: Seminar conducted on Non-State Pension Systems for 26 senior officials</p> <p>October: Pension Fund begins Office of the Actuary</p> <p>October: Pilot personified reporting programs begun in L'viv oblasts</p> <p>November: Ukrainian officials receive training in use of World Bank PROST model, and attend World Bank seminar on pension reform in the former Soviet Union</p> <p>December: Design and instructions for new Quarterly Survey of Household Income and Expenditures completed.</p>
ACTUAL AND PROJECTED ACHIEVEMENTS IN 1999	
<i>USAID/PADCO Project Activities</i>	<i>Actual and Projected Outcomes</i>
<ul style="list-style-type: none"> Implement reforms in delivery of pension benefits – transfer of responsibility for calculating benefits from MLSP to Pension Fund in L'viv Assist Pension Fund and Ministry to develop legislative strategy for reform of state and non-state pension systems Train staff in Office of the Actuary Develop personified database of all pensioners Assist with nationwide implementation of ARM-R, software for employer reporting of personified data on all Ukrainian workers to the Pension Fund Complete development of actuarial model of state pension system 	<p>February: Decree bringing all housing subsidy offices under subordination to MLSP issued by cabinet of Ministers</p> <p>March: Staff hired for office of Actuary through competitive examination</p> <p>March: Amendments submitted to Rada for law on non-state pensions</p> <p>April: Creation of Pension Reform Task Force to guide development of normative acts</p> <p>April: Training of staff of Office of the Actuary begins</p> <p>May: Issuing of Presidential Decree enacting reforms in the State Solidarity System</p> <p>May: 15 pension officials from Ukraine taken on</p>

<ul style="list-style-type: none"> • Design regulatory system for non-state pension funds • Study tours and seminars on pension reform issues in Europe • Assist Pension Fund and Ministry with planning for pilot non-state pension programs • Reduce privileges and entitlement programs 	<p>USAID sponsored study tour of Poland and Hungary</p> <p>July: Personified reporting program is rolled out nationwide</p> <p>November: Amended drafts of Non-state pension law and mandatory accumulation system law submitted to Supreme rada</p> <p>Transfer responsibility for calculating pensions from Ministry to Pension Fund nationwide</p> <p>Personified reports prepared by 25% of all enterprises in Ukraine by end of year</p> <p>Passage by Supreme Rada of amended laws on State and Non-State Pension Systems</p>
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2. A HISTORY OF PENSION REFORM IN UKRAINE: 1994-1999

2.1. BACKGROUND

The state pension system collapsed during 1993 and 1994, as hyperinflation reduced the real value of pension benefits by 70 percent. Invalids and the elderly quickly became the new poor. Their financial hardship was sadly exacerbated because inflation had also wiped out most of the value of the savings accounts held by many pensioners as insurance against economic adversity in old age. As more and more enterprises encountered financial difficulties, they became less and less regular in paying the Pension Fund. In 1996, the Government increased pensions for the first time in nearly two years. Predictably, pension arrears mounted. By mid-1998, arrears exceeded 2.5 billion Hrn – about 3 months of pensions. However, in some locations, pension payments were up to 8 months behind, and many payments were in-kind, rather than in cash. But pension reform did not begin seriously until USAID provided comprehensive technical support to the Pension Fund and to the Ministry of Labor and Social Policy.

2.2. TALKS, TALKS, AND MORE TALKS

Because of the size and urgency of the pension crisis, international donors were quick to offer advice. Beginning in 1994, international donors began sending advisors to help the GOU develop a strategy for pension reform. These advisors worked with counterparts in the State Pension Fund, the Ministry of Labor and Social Policy, and the Ministry of Finance, and with trade unions. They organized round tables, seminars, and conferences to educate officials about how pension systems operated in other countries and attempted to agree on fiscally and politically feasible reforms. Donors wanted to agree on the shape of pension reforms before

committing large-scale assistance. Discussions ranged over general issues -- raising the pension age, improving collections of contributions, starting a mandatory accumulation system, and relating benefits closer to work experience and earnings.

Unfortunately, no agreement was reached – for reasons with important lessons for designing technical assistance strategies. First, few Ukrainian counterparts understood the size or the causes of the problems. Neither the Pension Fund, the Ministry of Finance, nor the Ministry of Labor and Social Policy had built actuarial models to make projections. This lack of understanding could not be remedied because few participants trusted the information distributed at meetings by foreign advisors. With no agreement on facts, there could be no agreement about what to do.

In early 1997, TACIS, the World Bank, and the Harvard Institute for International Development each tried to market their own models. But the models were built with little participation from the Pension Fund or the Ministry, were poorly designed, inflexible, and failed to offer output in Ukrainian. Counterparts were expected to “trust” the models because of the foreign advisors’ superior expertise. Consequently, none of the draft reform laws submitted to the Supreme Rada in 1998 had been rigorously analyzed.

A second reason for failing to agree was the unwillingness of Ukrainian counterparts to consider reforms that would re-arrange responsibilities among different agencies. The desire to defend turf can blind even the best-qualified bureaucrat to the merits of proposed reforms.

Third, even if Ukrainians wanted to begin reforms, they didn’t know how to carry them out. Foreign advice was offered at a high level of abstraction that counterparts could not translate into

concrete implementation plans – which they couldn't afford to implement anyway. Departments administering the pension system are, by western standards, tiny. 120 staff in the whole Ministry in Kyiv manage all social protection programs – from childcare and welfare to systems for calculating and distributing pensions and managing dozens of orphanages and old people's homes. Pension reform, therefore, was blocked until USAID offered a comprehensive program of technical assistance.

2.3. ENTER THE WORLD BANK

The situation changed in early 1997. The extent of the deterioration of the State Pension system became less easy to deny and the March 1998 elections for the Supreme Rada were imminent. The GOU introduced a hastily conceived package of reform bills addressing bankruptcy law, pension reform, tax reform, the elimination of privileges, and proposals to accelerate privatization of state-owned assets. This package was divided into bite-sized portions by the Supreme Rada, and picked apart, bill by bill.

From the wreckage of the reform program, the Cabinet of Ministers created a Pension Reform Task Force in February. Its goal was to develop a pension reform package extensive enough to justify applying for a credit from the World Bank for between \$200 million and \$400 million to pay off pension arrears and finance systemic reforms in the State Pension system. The Task Force began meeting in April 1997 but by the end of June, its deliberations ended. The GOU rejected two “deal breaking” conditions set by World Bank experts: 1) to begin immediately raising the age at which people would be eligible to receive pensions; and 2) begin immediately to create a mandatory accumulation system.

A barrier to continued discussion was the failure to discuss how the massive -- and growing -- deficit in the State Pension system would be covered. This was the issue of primary concern to the GOU. With international donors taking only a “long-view” of the pension reform issue, and GOU counterparts unable to look beyond the immediate crisis, there was little basis for continued discussions.

3. A MORE PRAGMATIC APPROACH SUCCEEDS: 1997 – 1999

3.1. PRACTICAL WORK BEGINS

Following the suspension of talks in June 1997, USAID initiated a more pragmatic approach through its technical assistance contract with PADCO. Whatever changes were finally made in the state and in private pension systems, Ukraine needed to find ways to pay adequate pensions on time and to begin building the information infrastructure as the foundation for future pension reforms. PADCO's work focused on five areas of immediate importance to the GOU in developing a viable and politically feasible program of pension reform.

1. Developing actuarial models of the state pension system, creating an Office of the Actuary in the Pension Fund to administer these models, and the training of Ukrainian counterparts;
2. Personifying the reporting systems used by enterprises to the Pension Fund
3. Assisting the GOU and the Supreme Rada to draft and review pension reform legislation;
4. Providing training seminars and public education material to support pension reform.
5. Developing databases and communications systems to support the improved administration of the state pension system;

3.2. DEVELOPING ACTUARIAL MODELS

Under a new contract with USAID, beginning on February 1, 1998, PADCO brought in a new actuarial expert who began developing an actuarial model. The model was intended to provide short-term projections (10 years) for the Ukrainian pension system. It was developed in collaboration with the Ministry of Finance, the Ministry of Labor and Social Policy, and the Pension Fund of Ukraine.

This model allows separate estimates for the many different types of pension programs in Ukraine's complex pension system. The results are provided regularly to the Cabinet of Ministers and to the Supreme Rada to show the fiscal impacts of proposals to change the pension system. Counterparts now trust the numbers generated.

For longer-term projections, PADCO worked with the World Bank to apply the Bank's PROST pension model to Ukraine. They participated in World Bank training in Budapest and Moscow. The team has fully coded the model and calibrated it with Ukrainian data. All output is now provided in both Ukrainian and English. The model has been used to prepare 75-year projections of the current pension system and of proposed reforms.

In addition, at the project's recommendation, the Ministry of Finance approved the financing for an Office of the Actuary within the Pension Fund of Ukraine. Four staff have been hired with backgrounds in mathematics and computers. They will be responsible for fiscal analysis of the current pension system and of proposed changes to the system. Responsibility for developing and maintaining the actuarial models – the PADCO Excel model and the World Bank PROST model – will be transferred to this Office. This will give the GOU the permanent capacity to project revenues and expenditures of the state system through the complex and tense process of developing and implementing pension reform. At last, projections of the fiscal consequences of alternative proposals could be agreed to by all participants.

3.3. PERSONIFICATION

A brief summary of the previous reporting system shows why changes were needed. Every quarter, employers report to the local office of the Pension Fund aggregate wages and the total liability to the Pension Fund. Employers do not list the names of their employees. Employers maintain workbooks for each full time employee where service credits are accumulated. These workbooks are used to satisfy pension eligibility requirements and to compute the amount of pension benefits to be granted. But workbooks may bear little correlation to the period worked by the employee or to the pension contributions paid, if any, by the employer on behalf of that employee. Indeed, today entities may maintain workbooks for people who aren't really working there, allowing them to accumulate service credits with no contributions being paid on their behalf – perpetuating the gray economy. The current system allows much room for fraud. Personification is cutting down on these practices.

During 1997, PADCO programmers developed the software reporting program (ARM-R) which enables enterprises to maintain records on payroll contributions paid for each employee identified individually (using names and Taxpayer Identification Numbers issued by the State Tax Administration). Based on the recommendations of the Pension Fund, the Cabinet of Ministers of Ukraine began a large-scale pilot to test not only the software but also the speed and ease with which enterprises could adopt the new reporting system. The pilot program began in early 1999 in three raions in L'viv. Within two months, more than 400 enterprises were using the new software and sending reports to the local pension office electronically. The Pension Fund established a special office within each pilot raion to deal with personi-

fication issues. Local training workshops were held to demonstrate the new system to staff of the pension offices and to accountants from private enterprises. Local pension offices, equipped with new computers, entered the reports into a local database established with prototype software created by a Ukrainian software developer. The pension offices in the pilot raions reported an increase in contributions as a result either of the personified reports or of the public education campaign that accompanied the pilot program in the communities.

In the summer of 1999, the Pension Fund determined that the pilot program had demonstrated that the reporting system was "user friendly," and could be adopted easily by enterprise accountants. Most accountants had successfully adopted the program without receiving special training. The Fund decided that the nationwide rollout of the program would begin effective July 1, 1999.

Nationwide implementation is not an easy task. There are tens of thousands of enterprises with the computer capacity to use the reporting software. There are also thousands of certified accountants who provide accounting services to smaller enterprises. And there are tens of thousands of enterprises and hundreds of thousands of self-employed entrepreneurs that do not have computerized accounting records and will submit lengthy personified data on paper.

The Pension Fund planned a phased introduction of the system. PADCO developed several different ways to distribute information about the program and of dealing with the inevitable flood of questions raised by the new users of the system. First, 10,000 copies of the "Users Guide" and program disks were printed and duplicated by PADCO to be distributed from local pension offices to accountants. Material was also distributed at a series of workshops and seminars held in key locations to initiate the implementation of the program.

Second, PADCO created a special website which carried copies of the software program and the Users Guide as well as displaying frequently asked questions about personified reporting together with model answers. The Pension Fund included the website address in the material distributed to accountants through local pension offices. Between October 1, 1999, and November 18, 1999, more than 1,000 contacts with the website were recorded counter from all regions of Ukraine.

Third, the Pension Fund implemented a hierarchical "hotline" system for dealing with user questions. Local offices are the initial point of inquiry; those issues that local staff were unable to

answer were referred to oblast departments, and so on.

For the many thousands of companies that will continue, at least in the short-term, to submit reports on paper, PADCO is assisting the Pension Fund to evaluate and implement the use of scanners and optical character recognition software. This will allow paper reports to be read into computers without time consuming data entry by hand. As a result of detailed evaluations of alternative designs for such as system, USAID has purchased a scanner station to allow the design and testing of a practical workstation and processing system. There was an important collateral benefit of the strong emphasis on computers and software development. By developing the software used by employers to report personified data, PADCO became intimately involved in policy and legal issues raised by employers in using the new software. This allowed us to take the lead in developing amendments to laws and regulations, and changing ingrained administrative procedures.

3.4. LEGISLATIVE DRAFTING

Pension reform requires sweeping changes in the laws of Ukraine. In early 1998, the Supreme Rada passed a law that set the framework for pension reform. It is now considering several other major pension reform initiatives. Overall, Ukraine is following a plan to implement a pension system that includes three elements: a restructured state pension system; a mandatory contribution system; and a voluntary private pension system.

Ultimately, the hundreds of laws and cabinet decrees that have created the complex system Ukraine administers today will have to be changed. In the meanwhile, the legislative debate focuses on two draft bills prepared by the Cabinet of Ministers in 1998 and submitted to the Supreme Rada. The first makes sweeping changes in the existing solidarity system – beginning of a mandatory, funded system. The second bill would create private pension programs.

Both bills are flawed. But the PADCO team is working with the MLSP to suggest amendments that would make the reforms of the state pension system fiscally viable over the long term, and that would ensure that the non-state pension system is properly regulated to protect the interests of beneficiaries.

3.5. EDUCATION AND TRAINING

The emergence of an efficient, viable pension system in Ukraine depends on improving the understanding of pension issues among decisionmakers, increasing the technical skills of administrators, and broadening public appreciation of the need for pension reform. Therefore, an important element of the USAID/PADCO support for pension reform revolves around education and training.

For decision makers, PADCO has undertaken an extensive program of publication and distribution of papers explaining key aspects of Pension Reform. It is also holding a series of public seminars on critical pension issues. The staff of the Office of the Actuary has begun a long-term education and training program designed and conducted by PADCO that covers mathematical and statistical issues, actuarial principles, and the use of actuarial models.

Under development is a program to provide representatives of the media with a series of seminars on pension reform – backed by the widespread distribution of special publications describing issues for non-experts.

3.6. BUILDING DATABASES AND COMMUNICATIONS SYSTEMS

Administering state pension systems involves creating and maintaining the nation's largest databases and also the exchange of information with many other government agencies. The figure presented at the end of this paper shows schematically some of the most important interactions between Ukraine's Pension Fund and other entities -- identified by PADCO in its technical support work.

The process of building financial models of the pension system demonstrated to the government the need to create a national pensioner database. Currently, personified data on retirees is primarily maintained in raions. Raion databases are updated on a daily basis to reflect new pensioners, deaths, and other status changes. In some oblasts, raion databases are combined to create personified oblast databases, which are typically updated on a quarterly basis. However, there is no national pensioner database. Such a database is needed to evaluate the impacts of proposed changes in pension legislation. Currently, the Computer Center of the MLSP relies on personified data from only four raions for their analysis, and PADCO relies on data from just one oblast. Consequently, we have proposed the creation of a national pensioner database.

In addition, PADCO has developed the necessary software and communications systems to link local offices of the Pension Fund with local offices providing targeted social assistance. This minimizes effort needed for pensioners and invalids to receive social assistance.

Of course, these steps toward pension reform do not solve the problems that prevented agreement on the World Bank credit in 1997 – raising pension ages and beginning to fund the state sys-

tem. But PADCO, in consultation with the World Bank, is developing alternatives -- such as incentives for voluntary retirement delays as a substitute for immediate increases in the retirement age and a phased plan for the development and introduction of a mandatory accumulation system. By working through these steps collaboratively, more and more Ukrainian decisionmakers are beginning to understand the breadth and depth of needed reforms.

4. IMPROVING TECHNICAL ASSISTANCE PENSION REFORM

LESSON 1: PROJECTS SHOULD RESPOND TO HOST COUNTRY NEEDS, NOT TO ITS WANTS

Host countries will not commit resources to implement changes recommended in a technical assistance program unless the program meets an immediate need. Pension reform succeeded because the plight of pensioners was creating unsustainable pressures on the state budget. Pension reform has had, and will continue to have, an immediate impact on relieving fiscal pressures. Had pension reform been marketed to the government as a way of helping the poor, reform would have been much, much slower – if it would have proceeded at all. It is equally true that, had either program been marketed as a way of solving long-term needs, it would also have failed to attract any interest. The radar screens of decision makers in the former Soviet Union have a very short range.

Responding to host country needs does NOT mean waiting for the host country to define what it wants. Ukraine was certainly not aware that it “needed” to create a personified record keeping system for the solidarity system. The vast majority of officials in government are unaware of how to restructure their decaying administrative infrastructure. To be blunt, they do not know what they want, but will never admit to their ignorance.

Nevertheless, it was possible in 1997 to identify what Ukraine did, in fact, need. USAID moved quickly to deliver expert advice where it could persuade decisionmakers that there was no viable alternative. There is no simple way to measure host country needs. It requires a combination of establishing a relation of trust with key decisionmakers with the ability to assess immediate needs.

LESSON 2: BE FLEXIBLE

USAID’s projects must be flexible. It is impossible to predict how counterparts will respond to technical assistance: some ave-

nues for forward movement will close inexplicably; others will open unexpectedly. Contractors and USAID project officers must be prepared to change course quickly in whatever direction offers best way of reaching the final goal. Project flexibility depends on setting broad (but measurable) outcomes. In the case of pension reform, the goal is a fiscally sustainable pension system that provides adequate benefits to all retirees at a fair price.

Flexibility can only be maintained if USAID carefully monitors project outcomes. During the critical early months of the project, PADCO provided USAID with detailed weekly reports on its activities and the difficulties it was encountering. This ensured that USAID was amply warned when changes may be needed in the project design or when benchmarks may not be met. But monitoring outcomes requires the development of benchmarks against which to measure the progress of the project. USAID must adapt its benchmarks as projects change direction.

LESSON 3: BUILD ON SUCCESS

When the pension reform project began, it was recognized as a high-risk. The World Bank’s conditions for pension reform had been rejected by the GOU. As a result, the World Bank refused to provide financial or technical assistance for pension reform. Consequently, USAID provided limited funding – 18 months with one American and a staff of 7 Ukrainians. Before committing itself to further support for pension reform, USAID wanted tangible results from the government and the project team. Now, USAID has decided to continue its support for pension reform for another year, due to government support for personification, the creation of an Office of the Actuary, acceptance of fiscal models, and drafting laws on mandatory state pension insurance and on non-state pension funds.

The corollary of building on success is to terminate projects that do not achieve results. This does not necessarily mean terminating the project team. Flexibility in approach by USAID management, therefore, can rescue an unpromising project if the project team is sound. Nevertheless, when a project and a team have proved unable to deliver something of value, both should be cut off from further funding. It is a natural reaction when things do not work out as planned to believe that “more time is needed”. Unfortunately, this is often the triumph of hope over experience.

LESSON 4. PROJECTS MUST COVER IMPLEMENTATION AS WELL AS POLICY DESIGN

Policy advice – for the reasons discussed in the preceding sections, rarely works without support for implementation. However willingly government counterparts may be to carry out the recommendations of foreign experts, they lack the institutional infrastructure and staffing skills to implement even modest changes. Many have become adept at listening to the advice of foreign experts, cordially agreeing to implement whatever is recommended, only to abandon activity as soon as the expert left. Lacking even rudimentary office equipment, often unable to pay for long distance telephone calls, officials could do little without assistance, no matter how strongly they supported proposals for reform.

Technical assistance, therefore, must be comprehensive – not only pointing in the general directions of reforms, but also figuring out how to implement them. Technical assistance succeeds, therefore, only if it supports implementation. But most foreign experts do not enjoy the messy business of implementation -- it requires a level of knowledge that they prefer to leave to research assistants.

USAID sometimes relies too heavily on contractors hiring large number of US “experts” to manage and staff its programs of technical assistance. Experts certainly play a key roll – but not as large a roll as they are assigned in many projects. In fact, figuring out the design of the program or how to write draft laws, plays only a small part in success. Practical problem solvers are usually more important than “experts.” The ability to explain what needs to be done to counterparts is often difficult for experts – particularly those who spend only a short time in the host country. Many experts lack flexibility – their deep knowledge of one area may make it difficult for them to accept the compromises and imperfect products that are necessary in work in the former Soviet Union, where systemic change rarely happens according to plan.

All technical assistance projects sooner or later learn that the collateral systems necessary to support reform must be changed at the same time. It was soon evident that the Pension Fund lacked any databases and system for maintaining records of working Ukrainians. The project soon became involved in developing *de novo* the necessary software for automating reporting. The level of assistance had to be rapidly expanded and deepened to fill these gaps.

Project team members must also be flexible. Many key host country nationals had little direct prior expertise in particular areas – with the exception of the computer programmers. But they were adept at solving problems in the often-hostile environment of bureaucrats and policy-makers. They learned to be trainers, poster designers, organizers of press conferences, and instant “policy experts.”

But USAID’s flexibility allowed the project to expand the types of activities it engaged in as the limitations of the counterparts – financial and skills-related – became apparent. But this willingness to expand was based on the demonstrable successes of the project, not on the hope that something would eventually be achieved.

LESSON 5: CREATE A PROJECT STAFF OF HOST COUNTRY NATIONALS

The PADCO social sector reform project, of which pension reform is one piece, today has a staff of 42 people – including 34 professionals. But only two are Americans. The rest are Ukrainian experts with skills ranging from statistics and computer programming, to logistics and government administration. Creating a project staff of host country nationals creates a project team that can meet the unpredictable shifts in politics and in emphasis that foreign experts cannot do alone. The host country team should not be limited to translators and support staff. They should be hired and trained to participate in the day-to-day management and decision making of the project.

A strong team of host country nationals will help build the necessary trust between the project and its counterparts. Whether we like it or not, it is a fact of life that US-funded projects are viewed with considerable distrust among counterparts. Most senior bureaucrats were raised with the belief in the undying enmity of the USA toward the Soviet Union. This is not a view that dies easily – although soviet training has taught successful apparatchiks to conceal their distrust behind the mask of friendship. Working through host country nationals will sensitize US staff to politics and protocol – allowing the slow building of trust.

But, trust comes slowly – especially in nations that have had more than their fill of fly-by-night foreign experts.

Second, host country nationals will be much more aware of the details of the operation of government agencies, institutions, and customs than foreign experts. This helps orient project activities toward delivery of practical help rather than theoretical advice.

LESSON 6: EDUCATE COUNTERPARTS

Successful pension reform means that people are doing something differently and will continue doing it differently after USAID support is phased out. To encourage counterparts to do things differently, consider the following:

The importance of creating new MIS systems and automating operations of pension necessitate intensive, long term training. New local pension office staff quickly came to view themselves as part of a new national system – they were called to Kyiv for briefings and technical support staff visited them in their offices. This, in turn, stimulated peer pressure to come up with new ideas. Computers forced the MLSP, the Pension Fund, and the State Committee for Statistics into long-term collaboration with the USAID social sector reform project. They, eventually, became used to working closely with experts and to working collaboratively.

Training is a long-term activity. There is no tradition of training personnel in the former Soviet Union – at least, training in the way it is undertaken in the west. Bureaucrats have traditionally learned their job by shadowing the bureaucrat whose job they will be taking over. Only a top-management elite received training in more general and flexible skills. The development of regular training programs for all levels of staff under the personification program was necessary because there were no existing officials to shadow, and all staff needed to learn to use computers. It has been very important to train the MLSP how to use and how to deliver training.

Show, don't tell. Within Ukraine, the work of the pension reform project must be widely disseminated. This will be essential to the success of the programs that directly affect millions of people throughout the country. The extended pension reform project in Ukraine includes funding for an extensive public education program, including:

- Study tours to Latin America and the United States. Such tours have proved many times to be important in enabling counterparts to conceive of alternative ways of doing things

- Regional tours to Poland, Hungary, Croatia, and the Baltics, where pension reform has already been completed
- Preparing policy papers and special issues of local magazines devoted to pension reform
- Short brochures on pension reform topics, to be distributed throughout Ukraine
- Seminars in Kyiv on important pension reform projects
- Training journalists by including journalists in all study tours and seminars.

LESSON 7: PENSION REFORM MUST BE DRIVEN FROM THE TOP

The key elements necessary from the government of the host country in order to achieve pension reform are strong leadership from the Vice Prime Minister (or above), a Task Force with full-time expert staff -- relieved of all other responsibilities, and a commitment from officials and the Parliament to intensive study of pension reform through participation in educational programs.

Pension reform has a huge impact on the overall economy and on almost all the population. Consequently, responsibility for it cuts across the responsibilities of many different Ministries and organizations in the host country.

- Ministry of Labor and Social Protection: In Ukraine, they have overall responsibility for social policy and managing social protection programs. At least at the start of pension reform in Ukraine, they also had responsibility for calculating and paying pensions. The Computer Center of the Ministry also prepares projections of pension contributions and expenditures, through the Pension Fund, and directly through the State budget
- Pension Fund of Ukraine collects contributions, creates and maintains personified record keeping for the solidarity system, and, now, calculates and pays pensions from the Ministry of Labor and Social Protection. In the future, they will maintain individual accounts for any mandatory accumulation system. The Pension Fund is also responsible for projecting its revenues and expenditures through its Office of the Actuary
- State Tax Administration: Currently, they are not responsible for pension contribution collection. However, there have been discussions of moving this responsibility from the Pension Fund to the State Tax Administration
- Ministry of Economy: Their projections of GDP growth, real wage growth, inflation and

other factors are key inputs to any pension projection models

- Ministry of Finance: The Ministry is responsible for budget projections including projections of payments of social pensions, and finding how to finance (or not finance), shortfalls in Pension Fund revenues, social protection programs, and payments to the Pension Fund on behalf of government workers, etc.

The wide involvement of many agencies leads to inevitable conflicts and “turf battles” between Ministries that can only be overcome if the reform program is strongly lead by the Prime Minister or the appropriate Vice Prime Minister.

LESSON 8: PENSION REFORM IS PRIMARILY A SOCIAL SECTOR REFORM PROJECT

One of the reasons for the success of the pension reform project in Ukraine is that it is under the social reform area within USAID.

In other countries, pension reform has often been under capital markets. This creates a conflict of interest for USAID. Capital markets projects USAID view pension reform and privatization of the pension system as tools for developing markets, overlooking the primary importance of creating pension systems for the benefit of the participants. In many cases, benefit adequacy is ignored. Putting pension reform under social sector reform allows all social sector reform programs to be properly coordinated, leading to a more balanced analysis of reform options, including privatization.

LESSON 9: COORDINATE USAID CONTRACTORS AND AMONG INTERNATIONAL DONORS

Pension reform affects many different USAID projects – capital markets, fiscal reform, banking reform, accounting, and others. Usually these projects report to different departments within missions. Since pension reform cuts across so many functional areas, it is important to have a coordinating committee within USAID to discuss pension reform and its impact on different projects. The decision to create a “pension ombudsman” in USAID/DC has been an important step in recognizing this

More difficult is dealing with differences in pension reform approaches among contractors. It is embarrassing for USAID when different contractors present radically different approaches to pension reform to the government. To the extent possible, USAID needs to coordinate its programs

supporting pension reform without impinging on the professional integrity of its contractors.

Coordination among donors is difficult. USAID puts more contractors on the ground full time for extended periods of time than other contractors. Therefore, USAID should take the lead in coordinating among donors. It is of critical importance for the pension reform team to closely coordinate with the World Bank and the IMF, as their support will be needed for any pension reform.

Unfortunately, everyone seems to want to be involved in pension reform, and everyone seems to feel obligated to advocate their own approaches to pension reform, confusing counterparts. They lack the expertise to know a good approach from a bad one, or a good consultant from a bad one.

Table 1. Ukraine macroeconomic indicators in 1991-1999

	1991	1992	1993	1994	1995	1996	1997	1998	1999 ¹
Population², millions	52.1	52.2	52.1	51.7	51.3	50.9	50.5	50.1	49.9
Real GDP (1990=100)	91.3	82.3	70.6	54.3	47.7	42.9	41.6	41.0	
% change in real GDP	-8.7	-9.9	-14.2	-23.0	-12.2	-10.0	-3.2	-1.7	
% change industrial output	-4.8	-6.4	-8.0	-27.3	-11.5	-5.1	-1.8	-1.5	-0.5
% change agricultural output	-3.3	-8.2	1.5	-16.7	-3.6	-9.5	-1.9	-9.8	
Annual inflation	290	2,000	10,155	401	182	39.7	10.1	20.0	
% change in investment	-7.1	-36.8	-10.5	-22.8	-28.6	-22.0	-7.5	4.8	
Net investment, % of GDP	n. a.	n. a.	n. a.	16.3	8.4	4.6	2.9	-	
Budget balance, % to GDP	...	-12.2	-6.5	-10.5	-6.6	-4.9	-6.7	-2.2	
Employment*	-1.6	-4.0	-2.5	-5.1	-1.0	-5.0	-8.2	-0.4	
Unemployment rate, %:									
• registered	-	0.3	0.3	0.4	0.5	1.2	2.7	4.6	5.6
• labor force survey	-	...	...	...	5.6	7.6	8.9	11.3	12.5
% Change in real wage	6.1	-38.6	-51.5	-14.6	28.1	-13.8	-2.4	-12.9	-3.9
Real wage (1990=100)	106.1	65.1	31.6	27.0	34.6	29.8	29.1	25.3	
Exchange rate, (end of the year) ³	...	638	12,610	104,200	179,400	1,889	1,899	3.43	4.53
Discount rate, % (end of the year)	n. a.	80	240	252	110	40	35	60	45
Market capitalization (in bn USD)	...	...	...	...	...	0.3	0.5	0.6	0.8
Market capitalization (as % to GDP)	...	...	...	...	...	1.0	1.5	1.5	1.7
Pensioners, million	13.6	14.2	14.5	14.5	14.5	14.5	14.5	14.5	14.5
Pensioners, % of population	26.1	27.2	27.8	28.0	28.3	28.5	28.7	28.9	29.1
State Pension Fund expenditures as % of GDP	9.5	7.9	8.3	7.4	7.9	9.3	10.3	9.5	
Contributors per pensioner	1.69	1.55	1.46	1.37	1.31	1.23	1.15	1.15	1.15
Real pension (1990=100)	79.6	68.5	23.1	15.9	18.4	17.2	15.7	15.3	15.2
Replacement ratio (average pension to average wage, %)	36.1	35.3	68.4	45.1	36.1	36.6	38.9	36.1	39.1

Source: Ministry of Statistics, Ministry of Economy, National Bank of Ukraine.

Notes: 1 End of September, 1999

2. End of year.

3. Karbovanets, 1991 – 96; hrivnya thereafter

SUMMARY OF CURRENT PENSION SYSTEM

Exchange rate: US \$1 = 5 hryvnyas (UAH) (mid-November 1999)

STATE OLD AGE AND DISABILITY INSURANCE		SOURCE OF FUNDING
First law:	1922	Taxable wage base for coverage (cap): UAH 1,000
Current law:	1992	<i>Insured person:</i> 1% of earnings < UAH 150; 2% of earnings > UAH 150 < UAH 1,000 <i>Employer:</i> 32% of payroll
Type of program:	Social insurance system	

COVERAGE: All employees and self-employed, with Special provisions for victims of Chernobyl catastrophe.

ADMINISTRATIVE ORGANIZATION

Ministry of Labor and Social Policy: general coordination. Regional and local social protection departments, administration of program.

(State) Pension Fund of Ukraine payroll contributions' collection and pension benefits payments.

QUALIFYING CONDITIONS

Old-age pension: Age 60 and 25 years of covered employment (men), or age 55 and 20 years of work (women); requirements reduced by 5 or more years for arduous or hazardous work, mothers of 5 or more children or of disabled children, disabled veterans, and other specified conditions. Covered employment includes years spent in higher education, in serving armed services, in care of disabled persons or children under age 3; and in unemployment while seeking a job. Early pension payable to unemployed older workers (men aged 58-1/2 to 60 and women 53-1/2 to 55 who meet the requirements for covered employment) in case of enterprise liquidation or reorganization of enterprise.

Disability pension: Insured has a minimum of 1 to 15 years of covered employment, depending on age of onset of disability. Total disability (incapacity for any work): Group I (disability, requiring constant attendance); Group II disability (not requiring constant attendance). Partial disability (incapacity for usual work): Group III disability.

Survivor pension: Insured had up to 15 years of work, payable to surviving children whether or not dependents of the insured; and to nonworking dependents (including spouse; either parent, if disabled or not yet of pensionable age; grandparents, if no other support available).

Social pension: Citizens not eligible for old-age, disability, or survivor pension who are not working and: 1 aged 60 for men or 55 for women; and 2 disabled if disability began in childhood.

OLD-AGE BENEFITS

Minimum = UAH 24.9. Average = UAH 66.4. Replacement ratio (average pension/average wage) = 37%

Old-age pension: 55% of wage base if 25 years of work (men, or 20 year for women) of work, plus 1% of wage for each year in excess of 25 years (men, or 20 for women). Payable monthly. Maximum: 75% of wage base (85% for particularly hazardous working conditions); minimum pension: 200% of minimum wage (minimum wage: UAH 73.4 per month as of January 1999). Wage base equals gross average earnings in last 2 years or best 5 consecutive years during career. Partial pension (if insufficient years of covered employment): Monthly benefit reduced in proportion to number of years below required years of coverage; minimum, 50% of old-age pension.

Supplementary benefits payable to non-working pensioners with disabled dependents, and to pensioners aged 80 or older.

Social pension: 50% of minimum old-age pension.

Adjustment: Periodic benefit adjustments according to cost of living changes.

Careers allowance: Payable monthly to career of aged over 80 years old; career not otherwise employed, and may receive unemployment benefit.

PERMANENT DISABILITY BENEFITS

Disability pension: Total disability pension: Group I, 70% of earnings; Group II, 60% of earnings. Partial pension for total disability (if insufficient years of covered employment): Same as under old-age pension.

Partial disability (Group III): 40% of earnings. Payable monthly.

Social pension: 30%-200% of minimum old-age pension depending on degree of disability.

Careers allowance: Payable monthly to career of Group I disabled child under age 16; career not otherwise employed, and may receive unemployment benefit.

Adjustment: Periodic benefit adjustments according to cost of living changes.

SURVIVOR BENEFITS

Survivor pension: Payable monthly at 30% of wage base of the insured for each dependent; 40% of earnings for widow if spouse died in war. Minimum: 100% of minimum old-age pension per month.

Partial pension (if insufficient period of covered unemployment):

Monthly benefit reduced in proportion to number of years below the required years of coverage.

Funeral grant: 10 times minimum wage if employee, student, or unemployed; 2 months of pension benefits (or 10 times minimum wage, whichever is higher) if pensioner.

Adjustment: Periodic benefit adjustments according to cost of living changes.

Table 2. Types of Benefits and Eligibility Criteria

Types of pensions	Pension receivers	Eligibility criteria and amount of pensions
Old-age pensions: • ordinary • Special (for work in harmful and hard conditions (9 categories))	• Age status: men - 60 years old women - 55 years old Age status: men - 50; 55 years old women - 45; 50 years old	55% of salary (but not lower than a minimal amount of pension plus 1% for every work year above 25 (men) and 20 (women) but not more than 75% (85% for special pensioners) of salary. A minimal old-age pension is specified in the rate of a minimal consumer budget ¹ A maximal ordinary pension does not exceed 3 and special pension 4 minimal old-age pensions.
Disability pensions	Persons with full or partial disability because of: a) labor injury or occupational disease; b) general disease. There are 3 groups of pensioners depending on the disability degree.	I group of disability - 70%, II group of disability - 60%, III group of disability -40% of an actual average monthly salary. Minimum pension is specified in the rate of the social pension for a corresponding group of disability. Maximum pension cannot exceed 3 (4) minimal old-age pensions.
Survivor's pensions	Disabled dependents in case they lost their bread-winner	Pension rate for every disabled dependent is 30% of the bread-winner salary but not lower than the social pension specified for corresponding categories of the disabled.
Retirement pensions ²	Specific categories of employees engaged in works which cause professional disability prior to the pension age.	Assignment conditions and the rate of this pension are the same as for old-age pensions.
Social pensions	Nonworking citizens (except those disabled from childhood) who have no right for labor pensions.	a) of a minimal old-age pension rate is assigned to persons who reached pension age but did not receive the right for pension <i>without valid reasons</i> ; b) of a minimal old-age pension is assigned to persons who achieved pension age but did not obtain the right for the labor pension for a good reason; to III group of disability; c) of the minimal old-age pension is assigned to the II group of disability -II group invalids, children-invalids under 16 years old, children or one of the disabled in case the bread-winner loss; d) of the minimal old-age pension is assigned to the I group invalids, mothers with a title "Mother-Heroine".

¹ It is stated in the Law of Ukraine "On Amendments and Additions to the Law of Ukrainian SSR "On Minimal Consumer Budget" that in conditions of economical crisis and output decline a social normative - poverty line is being developed. Its structure, amount and value are being specified by the Cabinet of Ministers of Ukraine in collaboration with trade unions and are subject to annual approval by the Parliament.

² This category of pensioners is not numerous (38555 persons only or 0.3% of the total number of pensioners for the end of 1993). However due to the activities of some trade unions for the last three years their number has increased 1.5 times.

Table 3. The Number of Pensioners in Ukraine in 1970-1998
(000 the end of the year)

	1970	1980	1990	1995	1998
Population					
Total number of pensioners,	8,871	10,721	13,084	14,488	14,521
old-age pensioners,	5,458	7,329	9,713	10,615	10,473
<i>early retirement pensioners</i>	<i>n. a.</i>	852	1,614	2,037	2,155
disability pensioners	1,657	1,384	1,313	1,814	1,978
survivors pensioners	1,225	1,442	1,209	1,196	1,153
length of service pensioners	513	566	531	429	493
social pensioners	x	x	318	434	424
Pensioners as percent of the total population					
The total number of pensioners,	100.0	100.0	100.0	100.0	100.0
old-age pensioners,	61.5	68.4	74.2	73.3	72.2
<i>of them:</i>					
<i>early retirement pensioners</i>	<i>n. a.</i>	7.9	12.3	14.1	14.8
disability pensioners	18.9	12.9	10.0	12.5	13.6
survivor's pensioners	13.8	13.4	9.2	8.2	7.9
length of service pensioners	5.8	5.3	4.1	3.0	3.4
social pensioners	x	x	2.5	3.0	2.9

Source: State Statistics Committee, Ministry of Labor and Social Policy Social, author's calculations.